

**Before the
Federal Communications Commission
Washington, D.C. 20554**

In the Matter of)	
)	
Federal-State Joint Board)	CC Docket No. 96-45
on Universal Service)	(FCC 05J-1)
)	
Proposals to modify the Commission's)	
rules relating to high-cost universal)	
service support)	

**COMMENTS OF
PUBLIC UTILITY COMMISSION OF OREGON**

These comments are submitted by the Public Utility Commission of Oregon ("Oregon Commission") in response to the Public Notice released August 17, 2005 on behalf of the Federal-State Joint Board on Universal Service (FCC 05J-1).¹ The Public Notice seeks comment on four proposals to address universal service issues before the Joint Board.

Summary of Recommendations

- The universal service reform plan should comply with the principles contained in §254 of the Communications Act, the principles espoused by the NARUC Task Force on Intercarrier Compensation, and two additional principles proposed by the Oregon Commission.
 - §254 of the Communications Act requires that a full range of telecommunications and information services be available throughout the nation at rates that are reasonable, affordable, and, in rural and other high cost areas, reasonably comparable to rates in urban areas. Funding must be "specific, predictable, and sufficient" to ensure consumers have access to these services at these rates.
 - "Universal service funding should be technology neutral. Funding should be based on the most cost effective and efficient way to provide supported services. The technology employed must be capable of evolving to provide broadband services and must not constitute a barrier to providing advanced services."
 - "Support provided to high cost rural areas should not be based on whether that area is served by a "rural" or a "non-rural" carrier."

¹ Public Notice, Federal-State Joint Board on Universal Service Seeks Comment on Proposals to Modify the Commission's Rules Relating to High-Cost Universal Service Support, FCC 05J-1, released August 17, 2005 ("Notice"). These matters were referred to the Joint Board by an Order in the matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, FCC 04-125, released June 28, 2004 ("Referral Order").

- The amount of universal service support must balance the benefits to consumers in high costs areas with the cost to consumers throughout the nation of providing the support. Public policymakers must be able to control the growth in the Fund.
- The Federal and State universal service mechanisms contemplated by Congress must be coordinated in order to produce an integrated whole that meets the objectives of the Act.
- The Oregon Commission supports the State Allocation Method (“SAM”) Proposal developed by the NARUC Task Force on Inter-carrier Compensation and advanced by Joint Board Member Ray Baum. The SAM Proposal is the only one of the four described in the Notice that fully complies with all of the principles for a sound universal service reform plan.
 - The SAM Proposal complies fully with the principles in §254(b) of the Communications Act.
 - The SAM Proposal is technology neutral and provides built-in incentives for funding to be based on the most cost-effective and efficient way to provide supported services.
 - The SAM Proposal can support broadband without a large increase in funding.
 - The SAM Proposal contemplates a single mechanism for support of all rural areas.
 - The SAM Proposal allows the FCC to balance the benefits to supported consumers with the costs of support paid by other consumers.
 - The SAM Proposal is an ideal way to coordinate Federal and State universal service mechanisms.
- The proposal offered by former Joint Board Member Robert Nelson has substantial merit but must be modified in two important respects.
 - The rate benchmark for rural areas should not be quantified as 125% of the urban average until an implementation proceeding is conducted.
 - The benchmark should vary across wire centers based on factors affecting affordability such as household income and cost of living.
- The proposal offered by Joint Board Member Billy Jack Gregg has merit but involves too many stages. The latter stages would likely never be reached. If adopted, it would be very difficult to implement.
- The proposal offered by staff members Shifman, Bluhm, and Pursley has fundamental flaws and should not be adopted.

Introduction

The Oregon Commission very much appreciates the opportunity to comment on proposals to address pending universal service issues that have been offered by Members and staff of the Joint Board. These issues are extremely important to rural people in Oregon and throughout the country.

These proposals reflect an understanding by the Joint Board that universal service issues need to be addressed in a comprehensive fashion with a view to the long term. This is no

time to be satisfied with tweaking the current process; the time for fundamental reform is at hand. Funding for universal service is in jeopardy due to various technological, market, and regulatory developments. Simultaneously, the appropriate distribution of universal service funds is in question due to many of the same technological, market, and regulatory developments. Specific examples are the rise of wireless and IP services that substitute for traditional landline voice services. The issues associated with distribution of universal service funds are greatly exacerbated by the need for intercarrier compensation reform and designation of competitive eligible telecommunications carriers (“CETCs,” “ETCs”).

The Oregon Commission supports the State Allocation Method (“SAM”) proposal developed by the NARUC Task Force on Intercarrier Compensation (“NARUC Task Force”) and advanced by Joint Board Member Ray Baum. To explain our position, we begin with a discussion of the criteria that we have applied and that we believe the Joint Board should apply in adopting a reform plan. Next we discuss several specific aspects of the SAM proposal and explain how it satisfies the criteria we have recommended. Finally, we discuss why the other proposals do not meet all of these criteria.

The criteria for choosing the best universal service reform plan

The Oregon Commission recommends that the Joint Board use the following criteria in recommending a universal service reform plan.

- The universal service program must comply with §254 of the Communications Act.

Congress established universal service principles in §254(b) which should be very carefully considered:

(b) UNIVERSAL SERVICE PRINCIPLES.--The Joint Board and the Commission shall base policies for the preservation and advancement of universal service on the following principles:

(1) QUALITY AND RATES.--Quality services should be available at just, reasonable, and affordable rates.

(2) ACCESS TO ADVANCED SERVICES.--Access to advanced telecommunications and information services should be provided in all regions of the Nation.

(3) ACCESS IN RURAL AND HIGH COST AREAS.--Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

...

(5) SPECIFIC AND PREDICTABLE SUPPORT MECHANISMS.-- There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.

...

(7) ADDITIONAL PRINCIPLES.--Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this Act.

Principles (1)-(3) can be summarized as requiring that a full range of telecommunications and information services are available throughout the nation at rates that are reasonable, affordable, and, in rural and other high cost areas, reasonably comparable to rates in urban areas. Principle (5) is the oft-quoted requirement that funding be “specific, predictable, and sufficient” to ensure consumers have access to services as described in principles (1)-(3). Principle (7) contemplates that the FCC and the Joint Board will add principles as necessary and appropriate.

The Joint Board should accept the Congress’s invitation to establish additional principles that are necessary and appropriate at this time of fundamental reform. We have several to suggest.

The Oregon Commission has previously endorsed Version 7 of the NARUC Task Force on Intercarrier Compensation’s Proposal. That Proposal’s universal service section establishes several principles:²

- 1. Universal service funding should be technology neutral. Carriers should not experience changes in universal service funding based upon technological changes in their networks, i.e., converting from circuit-switched to IP. Funding should be based on the most cost effective and efficient way to provide supported services. The technology employed must be capable of evolving to provide broadband services and must not constitute a barrier to providing advanced services. Definitions of supported services should be modernized and made technology neutral.*
- 2. Support provided to high cost rural areas should not be based on whether that area is served by a “rural” or a “non-rural” carrier.*

These are important principles that should serve as criteria in choosing a universal service reform plan. The need for technological neutrality is amply demonstrated by recent experience. Policymakers did not foresee the pace at which IP and wireless technologies would develop and achieve consumer acceptance. We want ETCs to make the best

² See Letter giving Notice of Written Ex Parte Presentation to Marlene H. Dortch, Secretary, Federal Communications Commission from James Bradford Ramsay, NARUC General Counsel, June 9, 2005, CC Docket No. 96-45, Appendix D, p. 7. Available at: http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6517628153.

decisions for their customers free of any technology bias from the universal service support mechanism.

Policy-makers have a responsibility to see that universal service is provided in the most cost-effective and efficient way possible. This means spending no more money than is absolutely necessary to provide a given level of universal service. In a competitive market, the amount all suppliers receive is driven by the economics of the most efficient supplier. This is the same standard that should be used in distributing universal service funds to ETCs for the benefit of rural consumers.

The support mechanism must be free from any provider bias. There is no reason to favor “wireline” or “wireless” companies per se, independent of the services received by the customer. Each technology has strengths and weaknesses. Choices between wireline and wireless companies and services must be made in the usual fashion: by evaluating complex trade-offs between price and performance. Mobility has value, transmission quality has value, bandwidth has value, reliability has value, etc. The nation spends billions of dollars each year supporting universal service; it must spend the funds in a way that produces the greatest value for rural consumers.

No twenty-first century universal service program can ignore the importance of advanced services, broadband being the most prominent. A household without broadband service is increasingly cut off from the social, economic, political, educational and cultural life of our times. This is particularly true in rural areas where the availability of alternatives is much more limited. During the debate over whether DSL-based broadband internet access provided by telephone companies should be categorized as an information service, it became apparent that universal service funds already provide substantial support to incumbent “rural” ETCs for deployment of broadband services. Universal service reform must make this support explicit and truly universal.

This last point leads to the principle that support for universal service in high-cost rural areas should be based on the characteristics of the rural area, not on whether the ETC also serves low cost areas or how big the company is. This failure of the current program has particularly bad impacts in Oregon, where many of the poorest, most rural areas are served by “non-rural” companies. It is particularly aggravating that the people in these areas are forced to pay into the Federal Universal Service Fund to support other high cost areas but receive no support from the Fund simply because the wrong sign is on the side of the telephone company’s building. Beyond the obvious inequity, the separate mechanisms for rural and non-rural companies distort efficient ownership patterns by making support contingent on company characteristics rather than service area characteristics.

The Oregon Commission recommends that the Joint Board explicitly adopt the principles described above, as advanced by the NARUC Task Force on Intercarrier Compensation. For the reasons explained, they are necessary and appropriate.

The Oregon Commission believes that several other characteristics of a reformed universal service program are important. The following principle is necessary and appropriate:

- The amount of universal service support must balance the benefits to consumers in high costs areas with the cost to consumers throughout the nation of providing the support. Public policymakers must be able to control the growth in the Fund.

The universal service program is extremely large. According to the Universal Service Administrative Company (“USAC”), the totals for 2004 are as follows:³

High Cost	\$ 3,487,572,000
Low Income	\$ 758,828,000
Rural Health Care	\$ 1,147,000
Schools and Libraries	\$ 1,076,237,000
Total	\$ 5,323,784,000

As a result, the contribution factor exceeds 10%. Universal service funding is beginning to adversely impact the affordability of telecommunications services. USAC’s annualized projection for the fourth quarter of 2005 is that the High Cost Fund alone will grow to \$4 billion.⁴ With the current high level of the contribution factor and the demand on the Universal Service Fund to accommodate new services, additional ETCs, and intercarrier compensation reform, public policymakers must be able to control the growth in the size of the Fund. Indeed, representatives of States that are large net contributors to the Universal Service Fund are demanding it.

A final principle should be added:

- The Federal and State universal service mechanisms contemplated by Congress must be coordinated in order to produce an integrated whole that meets the objectives of the Act.

Congress could have established a universal service program that was funded and operated exclusively at the Federal level, but it clearly and explicitly chose not to. Presumably, it intended that the State programs not be mere facades, unfunded mandates to camouflage the true size of the Federal program. Nevertheless, the universal service principles clearly relate to the combined impact of both Federal and State programs. The only way to accomplish the Congressional intent is to coordinate the Federal and State programs.

The SAM Proposal

For the most part, the SAM proposal outlined in Appendix A of the Notice is familiar to all parties. We have already endorsed it in our recent comments in the intercarrier compensation proceeding.⁵ It is an idea developed by the NARUC Task Force during

³ USAC 2004 Annual Report, page 27, available at <http://www.universalservice.org/download/pdf/2004AnnualReport.pdf>

⁴ HC02, available at <http://www.universalservice.org/overview/filings/2005/Q4/default.asp>

⁵ See Comments of Oregon Public Utility Commission on Further Notice of Proposed Rulemaking in CC Docket No. 01-92, June 18, 2005. Available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6517610119.

more than a year of coordinated work on intercarrier compensation and universal service reform. There are several points which require elaboration.

The State Increment to the Federal Contribution Factor

The plan includes a provision that States be allowed to adopt an increment to the Federal contribution factor as a way to support their universal service efforts. This is a critical element of the plan in our view. If universal service goals are to be achieved through the combined efforts of Federal and State commissions in the way Congress intends, States must have a viable way to fund their efforts. Just as there is increasing recognition that the FCC cannot fund Federal universal service efforts by imposing a “tax” on interstate telecommunications service revenues, States are likewise increasingly unable to fund their universal service efforts through imposing a “tax” on intrastate telecommunications revenues. As a result of various FCC decisions, service provider revenues are increasingly beyond the reach of State universal service programs. If the FCC adopts a non-jurisdictional basis for Federal universal service contributions, such as telephone numbers or connections, providers will have an incentive to minimize their “intrastate” revenues. It makes sense that the States be allowed to use the same non-jurisdictional basis for funding State universal service programs. This would also save on administrative expenses as USAC could serve as the single universal service collection and distribution point.

The Determination of State Allocations

A critical question regarding the SAM mechanism is how the FCC would make the State allocations. This decision requires that data be collected and analyzed in order to develop a methodology. The transition timeline contained in the SAM Proposal suggests that the FCC make the first allocations to States in June of 2007. This allows plenty of time for the Joint Board to recommend and the FCC to adopt a carefully considered allocation methodology.

The SAM Proposal suggests a broad conceptual direction that might be taken in developing a methodology. Some method for determining the cost in each State to meet universal service goals is an obvious component of an allocation methodology. The two current methods for determining eligibility for rural and non-rural carriers (company-specific “embedded costs” and the FCC’s forward-looking cost model applied on a statewide basis, respectively) are not good candidates. The current “embedded cost” methodology for rural carriers has been amended, added to, and adjusted so extensively that it no longer resembles a true embedded cost methodology. It is more accurately thought of as a pragmatically determined method for distributing universal service funds to incumbent rural ETCs based on accounting costs. Similarly, the FCC’s forward-looking cost model has not been maintained and no longer represents the state of the modeling art. There are severe questions about the applicability of this model to small rural companies.

The SAM Proposal suggests that the issue of whether to use embedded or incremental costs, while important, is not central. The basic question is whether to use “actual costs,” whether embedded or incremental, or use a model. Models, whether embedded or

incremental, have many advantages. After the cost to develop them is incurred, they can be applied at relatively low cost compared to doing company-specific cost studies. Given the number of wire centers in the country, this is a very significant advantage. Using a model allows Federal and State commissions to better understand cost drivers. It creates incentives for service providers to be efficient and reduces the opportunities for gaming. It more readily allows the comparative analysis of different technologies.

Against the many advantages of models is the obvious disadvantage that no model is perfectly accurate. Ideally, model errors are random and cancel each other out. This means that, when the model is applied to all of the wire centers of a larger carrier or all of the wire centers in a State, the errors are not significant, but, when applied to a small rural company with one or a few exchanges that are potentially atypical, the errors may have a significant impact. The advantages of using a model to make a State SAM allocation are therefore not offset by the disadvantages of modeling. Since the FCC's allocation to the State and the State's distribution of its allocation to individual ETCs are separate decisions, the random errors will not have a significant impact.

The use of embedded models has been common in the industry for many years. Historically, most small company toll settlements were based on "average schedules," in reality very simple embedded cost models. They were simple to implement and easy to understand. The fact that they were called average schedules instead of models should not obscure the underlying reality.

The use of a cost model alone, however, is insufficient. There has recently been renewed attention to the fact that §254(b) addresses itself to rates, not costs. It is rates that consumers care about and it is rates that determine whether universal service goals are met. It was perhaps natural that regulators would make an implicit connection because of an unstated assumption that rates are based on cost. This assumption can no longer be made. In Oregon and in many other states, small incumbent rural ETCs' consumer rates are not regulated. Except in highly unusual circumstances, their overall rate of return is not regulated either. There is no basis for an assumption that rates are based on cost. A better operating assumption for the future is that ETCs are unregulated private businesses; as a result their rates will be based on demand as well as cost considerations.

Affordability and the Rate Benchmark

The exclusive focus on costs in distributing universal service funds is wrong in another respect as well. §254(b) requires that rates for universal services be "just, reasonable, and affordable." Affordability is a function of demand, not cost. This is implicitly recognized by the Low Income Fund. The Low Income Fund, however, only addresses families living in or near poverty. The issue of affordability is clearly broader than this. The statute therefore requires that universal service distributions be based not only on the cost of providing service in a particular high cost area, but on what people in that area can afford as well. That is why some commentators have criticized the universal service program for not distinguishing between a rural community that is home to a major ski area and a rural community that is dependent on a declining agricultural or resource economy. A rate that is affordable in the former may be prohibitive in the latter.

These issues of affordability and reasonable comparability have been discussed extensively during the NARUC Task Force on Inter-carrier Compensation Workshops. The concept of a rate benchmark seems to be widely accepted. Essentially, a rate benchmark means that local consumers are expected to contribute a certain level of revenues to recover the costs of the local network before universal service funding is available. Comparisons to the benchmark can also be used to ensure that rates are reasonably comparable.

An idea brought forward more recently is that the benchmark should not be the same everywhere, but, rather, should depend on economic variables such as median household income, cost of living, etc. that are available in census data. In so doing, such a plan would implement the principles described above in a number of ways, most importantly by explicitly addressing affordability. It would say that a poor rural community with a declining agricultural or resource economy cannot afford the same rates that a vibrant rural town with a ski resort can. If this approach is adopted, a benchmark would be established that would vary in each wire center based on economic variables such as median household income and cost of living.

The Oregon Commission believes this idea has merit and should be pursued in the implementation proceedings that occur between now and the first SAM allocations in June of 2007.

The SAM Proposal satisfies the criteria for a sound universal service reform plan.

The SAM Proposal complies fully with the principles in §254(b) of the Communications Act.

As already described, §254(b) principles (1)-(3) can be summarized as requiring that a full range of telecommunications and information services are available throughout the nation at rates that are reasonable, affordable, and, in rural and other high cost areas, reasonably comparable to rates in urban areas. Under the SAM Proposal, the FCC would establish guidelines for State programs and review proposed programs for compliance with §254. The FCC guidelines would include specific requirements implementing the principles established by Congress. State plans that the FCC finds are out of compliance with the Act or the Commission's guidelines would not be implemented.

Allocations of universal service funds to each state would ensure that the services are available in all regions of the country, as required by Congressional principle (2).

The SAM Proposal establishes "specific, predictable, and sufficient Federal and State mechanisms to preserve and advance universal service." The SAM Proposal suggests that State allocations could be made for five years at a time in order to provide further predictability.⁶ States could also make distributions to ETCs for a similar time period. It

⁶An objection to the SAM Proposal that is sometimes made is that State regulators will be subject to the political winds that blow in State Capitals. This is, in reality, an attack on democratic institutions. We

is important to emphasize that this Congressional requirement is addressed to stability for consumers. It does not require stability for individual ETCs. Indeed, the essence of operating in a competitive market for communications and information services is that stability results from continuously offering the best service at the best price, not from guaranteed government funding.

The SAM Proposal is technology neutral and provides built-in incentives for funding to be based on the most cost-effective and efficient way to provide supported services.

One of the strongest advantages of the SAM Proposal is that it is technology independent. As technology evolves in unpredictable ways, States can reflect the new opportunities to better serve consumers in their distributions to ETCs.

The SAM Proposal would lead to more cost-effective and efficient ways to provide supported services in a number of ways. A well-known strength of American federalism is that the States can serve as laboratories for experimentation. As successful experiments become known throughout the country, they can and will be replicated.

States will have strong incentives to distribute their allocations in the most cost-effective and efficient way because each dollar distributed will have an opportunity cost. They will be able to use their local knowledge to make tailored distributions. They will be able to base their distribution decisions on ongoing direct knowledge of how various ETCs are performing and whether they are living up to their commitments.

At the same time, the FCC will be able to use its responsibilities for establishing guidelines and approving State distributions of Federal funding to ensure that national priorities are being met. This is a great improvement over the current situation in which the FCC's role is limited to approving cost accounting rules and limited financial auditing. As a result of the review, it will be in a position to ensure that successful experience in one State is transferred to similar situations across the country.

The SAM Proposal can support broadband without a large increase in funding.

As already described, the current USF program provides substantial support for DSL when it is provided by a rural company but often not when it is provided by a non-rural company in a similar rural area. As a result, broadband deployment in Oregon is much more extensive in incumbent rural ETC territories than it is in the rural territories of non-rural ETCs.

It is a fundamental error to think of broadband as a network or service that is separate from the voice network. It is more accurate to think that we used a narrowband network to support voice and information services in the past and that now we are evolving to a broadband network that will support voice and information services. Congress decided

have noticed that political winds blow inside the beltway as well. In the end, State legislatures and commissions are more likely to be responsive and accountable to local consumers' needs than a distant federal agency. If not, then they will fall behind other States and be forced to change.

that universal service funding should support an advanced network that is capable of providing a wide variety of voice and information services. The implication of this statement is that the entire universal service program should be supporting a sensible evolution from narrowband to broadband networks, wireline and wireless. The SAM Proposal is an ideal way to do this. It would allow the FCC and the States to be actively involved on a continuing basis in managing the use of the public funds that support this evolution. It is far more flexible than the current approach, which depends on private decisions in response to changes in cost allocation rules.

No one knows for sure the best way to provide broadband services in very rural, hard to serve areas. Some maintain that suitable broadband services can only be provided by wireline technology, but the best answer is likely to be a mixture of wireline and wireless technologies. A recent report by the FCC's Wireless Broadband Access Task Force makes clear that wireless technologies will be the best choice in some rural areas:⁷

In addition, wireless broadband plays a critical role in ensuring that broadband reaches rural and underserved areas, where it often is the most efficient means of delivering these services.

There are several directions that wireless broadband technology is taking. Existing wireless operators are looking to deploy CDMA2000 1X EV-DO Revision A technology that has transmission speeds equivalent to DSL.⁸ WiMax is a new standard for wide area broadband that has been embraced by major market participants, including Intel, SBC and Qwest.⁹ Even though standardized technology and optimum spectrum are not yet available, broadband wireless competitive in bandwidth and price with DSL is available in many markets, including a number in Oregon, today.¹⁰

By not treating broadband as a separate funding priority, by not making any implicit assumptions about the direction of technology, and by not making any "one size fits all" choices, the SAM Proposal represents the most cost-effective and efficient means of funding the evolution to broadband in rural areas for the benefit of rural consumers.

The SAM Proposal contemplates a single mechanism for support of all rural areas.

The SAM proposal would make no distinction whatsoever between "rural" companies and "non-rural" companies, instead focusing on the characteristics of rural areas

⁷ Connected On the Go, Broadband goes Wireless, Report by the Wireless Broadband Access Task Force, Federal Communications Commission, February 2005, p 2.

⁸ "Verizon, Lucent Ready Rev. A Trial," by Susan Rush in WirelessWeek, August 18, 2005. Available at <http://www.wirelessweek.com/article/CA635986.html&>.

⁹ <http://www.wimaxforum.org/about/roster/>. It is imperative that these technologies be available to all ETCs. Indeed, one of the most important things the FCC can do is make suitable spectrum available to all ETCs as soon as possible for the deployment of WiMax in rural areas. Unfortunately, the best spectrum is tied up in the transition to digital television. See http://www.wimaxforum.org/news/downloads/WiMAX_Forum_Regulatory_Whitepaper_v08092004.pdf, pp. 5-6.

¹⁰ See, e.g., <http://www.clearwire.com/index.html>

themselves. In this way, it treats all rural Americans equitably and does not unfairly discriminate among companies. This is essential if the goals of §254 are to be realized.

The SAM Proposal allows the FCC to balance the benefits to supported consumers with the costs of support paid by other consumers.

Currently, the FCC has little direct control over the size of the High Cost Fund. Having established a cost methodology, support is available to all ETCs designated by State commissions pursuant to that methodology. Consumers who pay for universal service are not necessarily those who receive the benefits and the payment is involuntary. As a result, government has a responsibility on behalf of those consumers from whom it obtains universal service contributions to weigh the costs and benefits of universal service support.

The statutory process under which States designate additional ETCs for Federal Universal Service support, in conjunction with the way support is currently distributed to ETCs, may not always allow this to happen. There is almost certainly some benefit to be obtained by a State in designating additional ETCs, but the cost is largely borne elsewhere in the country. It is inherent in this process that the number of ETCs will grow rapidly, almost certainly resulting in some designations that fail any reasonable benefit/cost test. The incumbent ETCs' universal service funding in the State does not fall and the newly designated ETC's funding increases the size of the High Cost Fund.

The SAM Proposal addresses this issue very well. In the context of periodically making State allocations, the FCC will be in a position to weigh the overall costs and benefits of the program. As a byproduct of this consideration, it will directly control the size of the fund. Similarly, in the context of periodically making distributions to ETCs from their States' allocations, State commissions will weigh the costs and benefits of their decisions very carefully. They will have an incentive to maximize the public benefit of the Federal allocation to their States. In this way, the costs and benefits of funding additional ETCs are aligned because funding of an additional ETC will come out of the State's allocation rather than from consumers elsewhere in the country.

Currently, States are responsible for annual recertification of ETCs, but this process does not work very well. States have only two options: to recertify or not to recertify. The option of not recertifying an ETC is so draconian that it is rarely, if ever, used. As a result, many States rely on affidavits from the ETCs as the sole basis for recertifying them. Allowing States to make distributions of an overall allocation to the State will give them viable tools to ensure that ETCs are providing consumer benefits commensurate with the universal service funding they receive.

The SAM Proposal is an ideal way to coordinate Federal and State universal service mechanisms.

One of the key features of the SAM proposal is the way it integrates Federal and State universal service efforts. States would receive an allocation of Federal funds and could add to the amount available by applying an increment on the Federal funding mechanism

applicable within their states. The total amount would be distributed to ETCs pursuant to distribution decisions made by the States.

The proposal offered by former Joint Board Member Robert Nelson has substantial merit but must be modified in two important respects.

Former Member Nelson's proposal, contained in Appendix C of the Notice, has much to recommend it. In broad outline, both former Member Nelson's proposal and Member Baum's proposal endorse the SAM concept developed by the NARUC Task Force. The differences are mainly in the details, primarily with the implementation of the benchmark. The SAM proposal advanced by Member Baum does not include 125% of the urban average as the quantification of the benchmark. Substantial concerns have been raised that a 125% standard will mean that rural rates are below many urban rates and this may be unreasonable. Secondly, as described above, the SAM proposal reflects recent thinking that the benchmark should vary across wire centers based on economic factors such as median household income and cost of living.

The proposal offered by Joint Board Member Billy Jack Gregg has merit but involves too many stages. The latter stages would likely never be reached. If adopted, it would be very difficult to implement.

Member Billy Jack Gregg's proposal, contained in Appendix B to the Notice, advocates a "fresh look" at universal service issues but assumes that reform must take place over three stages because of the perceived limited scope of the current referral. That concern has, however, now been obviated by the instant Notice; it seeks comment on four broad proposals for fundamental reform. This is not to say that the record developed will be sufficient to establish all of the details of the universal service reform plan. Subsequent proceedings addressing implementation issues will be necessary, and Member Baum's proposal contains a schedule suggesting the nature of and timeframes for these further proceedings. The record will, however, be sufficient for the Joint Board and the FCC to make a policy decision, and the pressing need for fundamental reform demands that they do so now.

Each of the stages of Member Gregg's proposal involves significant policy changes. In the case of the latter two stages, based respectively on the Universal Service Endpoint Reform Plan ("USERP") addressed below and the SAM Proposal, the changes are fundamental, sweeping, and in very different directions. It would be difficult to put the industry, Federal and State regulators, and the rural public through three stages of change. The Oregon Commission believes it is unlikely that Stage 3 would ever be implemented. If this proposal is adopted the Joint Board should decide what direction it wants to take and establish either the SAM approach or the USERP plan as Stage 2 and drop stage 3 of the proposal.

Some of the adjustments to the current rural support mechanism recommended for Stage 1 have merit. However, if the mechanism is going to be substantially replaced in Stage 2, it is questionable whether these interim changes are advisable. Some of them would

require substantial effort by regulators and the industry to implement. They could significantly impact funding levels, which could then change in Stage 2, perhaps in the opposite direction. The Oregon Commission urges the Joint Board to instead move away from the current separate rural mechanism for rural service providers and to begin work on a single rural mechanism for all service providers.

The Proposal concludes its discussion of Stage 1 with the following words:¹¹

Adoption of the proposals contained in Stage One would stabilize the fund over the next three to five years, but allow carriers to rationalize their service areas and business plans.

Given the volatility of the communications and information industries, if the Joint Board and the Commission were to mandate all of these changes and expect them to last for five years, why would it make sense to specify any subsequent stages? Wouldn't eliminating the subsequent stages be the only way to "allow carriers to rationalize their service areas and business plans?" If not, on what basis would they rationalize them?

In Stage 2, the Stage 1 Plan would be replaced by an entirely new embedded cost methodology "almost exactly the same as proposed in [the USERP Plan]."¹² We will address the USERP Plan in the next section, but a particularly troublesome aspect of its adoption in Stage 2 is that it would only apply to "rural" carriers.

Stage 2 appears to mandate State plans at prescribed levels:

Primary federal support should not be 100% compensatory for excess costs in order to provide an incentive for efficiency, and to provide a role for state universal service funds in achieving comparable rates.

This appears to place an unfunded mandate on the States.

Stage 3 proposes a "block grant" system similar to the SAM Proposal. The Oregon Commission believes that Stage 3 will not occur because of the time and effort required for implementation of Stages 1 and 2. As previously stated, if such a system is desirable, it should be implemented as a Stage 2 in lieu of the one proposed. Our recommendation is that it should supplant Stage 1 as well.

The proposal offered by staff members Shifman, Bluhm, and Pursley has fundamental flaws and should not be adopted.

The USERP Plan is based on the premise that the principle of technological neutrality should be abandoned and we oppose it on this ground alone. It creates two separate

¹¹ Notice, Appendix B, p. 10.

¹² Ibid.

mechanisms, one for wireline technology and one for wireless technology. The justification is as follows:

This policy change reflects the fundamental cost, regulatory and rate differences between wireless and wireline service. There are also functional differences that limit substitution of one service for the other.

Contrast this with the experience of BellSouth:¹³

BellSouth Corp., a regional phone provider based in Atlanta, said the main threat to its traditional fixed-line business is wireless calling, rather than Internet-based phoning, according to a spokesman.

"The main reason that people disconnect from us is to go wireless," said Jeff Batchner, the BellSouth spokesman. "We are seeing minimal competition" from the Internet-phoning providers and other voice applications on the Internet, he added.

Marketplace substitutes can have fundamental functional differences and still be highly substitutable. It is for consumers, not regulators, to determine substitutability.

The USERP Plan would create a separate fund for wireless, capped at \$1 billion. The authors report that wireless currently contributes \$1.8 billion, a number that is surely growing rapidly, so this aspect of the plan creates a permanent subsidy of wireline technology by wireless technology without even examining what is best for the rural consumer. Moreover, unlike the wireline fund, the wireless fund sunsets after five years, raising the possibility that all of the universal service contributions from wireless carriers would be used to subsidize their wireline competitors.

The USERP Plan seems to ignore the trends in wireless technology that were discussed above. The fact is that wireless cannot be dismissed as a viable alternative to wireline technology in rural areas. Suppose, for example, that the most viable alternative for broadband in some rural areas is WiMax and that voice is an application that can ride on this broadband network. Why should the Joint Board make an a priori assumption that wireline technology is best in every rural area? Why should the Joint Board discourage wireline companies from adopting wireless technology if that is the best alternative in specific rural situations?

Technological neutrality is a basic criterion by which a universal service reform plan should be judged. If the USERP Plan is adopted, the separate funds must be eliminated. This immediately raises a series of basic questions, however, because this is the mechanism in the USERP plan that determines how funds are allocated among technologies. In the absence of such a mechanism, the alternative is to fund all technologies in every rural area, something we clearly cannot ask other consumers to pay for.

¹³ "Google to Introduce Instant Messaging," The Wall Street Journal (New York: Dow Jones, August 24, 2005), p. B3.

Although the USERP Plan purports to adopt a State Allocation Mechanism, in reality it does not. Instead, it establishes an embedded cost methodology for determining the total company revenue requirement for each incumbent wireline carrier, perhaps adjusted by “best in class” standards in certain cost categories. Part I support would be provided only to a limited number of states where the aggregated embedded cost is above average. As the Proposal notes:¹⁴

This would effectively assign states the principal responsibility for universal service support within their own borders.

Thus, many states would get nothing even if they have very high cost rural areas within their borders. The result is that Federal high cost support would be even further concentrated than it is today.

The Part I support section concludes with a key paragraph, here quoted in full (footnotes omitted):¹⁵

The plan would set a benchmark standard to ensure that Consumer Cost is affordable and reasonably comparable. A “permanent benchmark” would be set at 125 percent of the national average urban cost (net of intercarrier revenue). Support to each state would be sufficient to keep this cost at or below the benchmark everywhere in that state. This provides a functional definition of “affordable” and “reasonably comparable” rates. The effect would be that, after federal support has been received, average Consumer Cost would be, in every state, no higher than the benchmark.

Except during a transitional period, the plan does not provide more support than is necessary to achieve affordability and comparability. Specifically, no state should have so much federal support that it could set some rates (which reflect Consumer Cost) below the benchmark and still have enough federal support to keep other rates from rising above the benchmark.

As this quotation makes clear, the purpose of the plan is to make sure that consumer rates in selected states are no higher than the benchmark. Funding is just sufficient to realize this goal, so, clearly, states receiving Part I support have no discretion in the distribution of funds.

What about the other states that don’t receive Federal funding? These states are required to meet the Federally-mandated benchmark for consumer cost with their own funds. The state programs are thus seen for what they are: mere facades, unfunded mandates to camouflage the true size of the Federal program. If there is any doubt about this, the section on “Non-Participating States and the Federal Overlay” makes clear that the FCC

¹⁴ Notice, Appendix D, p. 22.

¹⁵ Ibid.

would step in and establish a universal service program for a non-participating state, funded with “a supplemental universal service charge that applies only in one state.”¹⁶

There is no point in establishing a so-called State Allocation Mechanism merely to disguise the true extent of the Federal program. If this is the direction that the Joint Board and the FCC want to take, they should do so by establishing a comprehensive Federal program funded with a differential contribution mechanism that varies on a state by state basis.

Curiously, the USERP Proposal also includes provisions for Part II support in addition to the Part I support already described. The Oregon Commission cannot understand why, if Part I operates as intended, Part II support is necessary.

Finally, the 125% benchmark proposed in the plan does not address the affordability criteria found in section 254(b)(1) of the act via the use of economic variables, such as median household income and cost of living, to address the concerns the Court raised in the recent Qwest II decision.



Lee Beyer
Chairman



John Savage
Commissioner



Ray Baum
Commissioner

¹⁶ Ibid., p. 25.